Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Review of the Commission's Rules Regarding	)	
the Pricing of Unbundled Network Elements	)	WC Docket No. 03-173
and the Resale of Service by Incumbent Local	)	
Exchange Carriers		

Reply Comments of
<u>The Nebraska Rural Independent Companies</u>

I. Introduction

The Nebraska Rural Independent Companies[1] (the "Nebraska Companies") hereby submit reply comments in the above captioned proceeding. The Nebraska Companies appreciate the opportunity to reply to comments in this matter filed in response to the Notice of Proposed Rulemaking[2] of the Federal Communications Commission (the "Commission"). Specifically, the Commission sought comments in a comprehensive review of the Total Element Long Run Incremental Cost ("TELRIC") methodology that was adopted for the pricing of unbundled network elements ("UNEs") seven years ago.

As the Nebraska Companies noted in their comments in this proceeding, while many rural incumbent local exchange carriers ("ILECs") have not provided UNEs

[1] Companies submitting these collective comments include: Arlington Telephone Company, The Blair Telephone Company, Cambridge Telephone Company, Clarks Telecommunications Co., Consolidated Telephone Company, Consolidated Telco, Inc., Eastern Nebraska Telephone Company, Great Plains Communications, Inc., Hartington Telecommunications Co., Inc., Hershey Cooperative Telephone Company, Inc., Hooper Telephone Company, K&M Telephone Company, Inc., NebCom, Inc., Nebraska Central Telephone Company, Northeast Nebraska Telephone Co., Pierce Telephone Co., Rock County Telephone Company, Stanton Telephone Co., Inc. and Three River Telco.

[2] *See Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, FCC 03-224 (rel. Sept. 15, 2003).

because they have not received interconnection requests, rural ILECs, such as the Nebraska Companies, have negotiated agreements for the transport and termination of traffic from wireless carriers. Due to the fact that the volume of terminating wireless traffic is growing, the potential revision of rules that establish the basis of pricing for wireless transport and termination is of great importance to rural ILECs. As in their comments, the Nebraska Companies will focus their reply comments exclusively on recommendations made by other commenting parties which would affect the pricing of transport and termination.

II. The Commission Is Justified in Using the Same Pricing Rules for UNEs and Reciprocal Compensation.

Cox Communications, Inc. ("Cox") asserts that UNE rates should be set using one pricing methodology, while reciprocal compensation rates should be set using a separate and distinct methodology.[3] Cox argues that since there are separate provisions governing rates for UNEs and reciprocal compensation in the Telecommunications Act of 1996 (the "Act"), and, furthermore, that the rate-setting standards of the two provisions are different, that Congress intended for the Commission to adopt different pricing rules for UNEs and reciprocal compensation.[4] However, if Cox researches the legislative history of the Act, it would find a simple reason for the two provisions governing pricing, namely, that the Act was a result of a conference agreement between H.R. 1555 and S. 652.

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[3] *See Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, Comments of Cox Communications, Inc. (*"Cox Comments"*) (filed Dec. 16, 2003) at p. 3.

[4] Ibid.

H.R. 1555 contained Section 242 (b)(2), which stated pricing standards for reciprocal compensation that are almost identical to those contained in the Act as enacted.[5] S. 652 did not contain any specific language regarding pricing standards for reciprocal compensation. Likewise, S. 652 contained Section 251(d)(6), which detailed pricing standards for UNEs and interconnection,[6] while H.R. 1555 did not include any standards for the pricing of UNEs and interconnection.

The Conference Report on the Act further documents that the two different pricing standards were a result of the process of combining the two bills in conference. The report states "[n]ew section 252(d) *combines the pricing standards in the Senate bill and the House amendment*."[7] (emphasis added) The report does not mention that two different pricing standards, one for transport and termination, and another for UNEs and interconnection, were adopted because the Congress saw a need for different standards. Rather, it appears that the two standards for pricing were the result of the normal legislative process of combining House and Senate legislation into a single bill.

Cox recommends that reciprocal compensation rates should be allowed to be set no higher than forward-looking long-run incremental cost, which does not include an allocation of joint and common costs.[8] Cox suggests that a price ceiling of long-run incremental cost for the pricing of reciprocal compensation ". . . keeps reciprocal

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[5] *See* H.R. 1555, 104th Cong., 1st sess., (1995).

[6] *See* S. 652, 104th Cong., 1st sess., (1995).

[7] *See* U.S. Congress, House, Conference Report on S. 652, Telecommunications Act of 1996, 104th Cong., 2nd sess., January 31, 1996, Congressional Record, House, January 31, 1996, at p. H 1110.

[8] *See Cox Comments* at p. 3 and at Exhibit 1, p. 25-26.

compensation rates from being so high that they distort competitive incentives."[9] Cox made the same recommendation concerning the pricing of reciprocal compensation in the Commission's initial proceeding regarding the Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98 ("Local Competition Proceeding").[10] The Commission rejected this recommendation for the pricing of reciprocal compensation in that docket, and the Commission's reasons for rejecting the recommendation remain valid today.

In the Local Competition Proceeding, the Commission noted that ". . . commenters generally agree that incumbent LECs should be permitted to recover some measure of forward-looking joint and common costs."[11] The Commission also noted that:

> These commenters argue that pricing at incremental cost without joint and common costs is economically inefficient because it permits competitors to offer the incumbent LECs' services without making a contribution to the common costs that the LECs incur in offering the service. They further contend that *excluding recovery of joint and common costs will distort technological decisions because the LEC is encouraged to invest in less efficient technologies that have higher incremental costs and lower common costs*, which would tend to destroy economies of scope. Finally, *incumbent LECs fear that they will be forced to increase retail rates to recover these unrecovered common costs*, while their *competitors that do not face such costs will reduce their own prices and have little incentive to invest in facilities of their own.*[12] (emphasis added)

[9] *Cox Comments* at p. 3.

[10] *See Cox Comments* at Exhibit 1, p. 25-26.

[11] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, and *Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket No. 95-185, First Report and Order , FCC 96-325 (*"Local Competition Order"*) (rel. Aug. 8, 1996) at para. 643.

[12] Ibid.

Given the foregoing rationale, the Commission concluded that forward-looking common costs should be allocated among elements and services in a reasonable manner.[13]

In adopting an approach to the pricing of UNEs, interconnection, and reciprocal compensation that included joint and common costs, the Commission also indicated that it had considered the economic impact of its pricing rules on small ILECs.[14] The Commission stated that while small ILECs were opposed to the use of a forward-looking, economic cost methodology, such ILECs favored the recovery of joint and common costs in the event that the Commission adopted such a methodology.[15] Moreover, the Commission noted that the pricing methodology that it adopted is designed to permit ILECs to recover their economic costs of providing interconnection and unbundled elements, which may minimize the economic impact of its decisions on small ILECs.[16]

The Commission had sound reasons for including joint and common costs in its cost-based pricing standard. Contrary to the assertions of Cox that current rules for pricing reciprocal compensation have resulted in rates ". . . so high that they distort competitive incentives,"[17] failing to allow the recovery of joint and common costs in the cost-based pricing standard could result in inefficient investment that may reduce joint and common costs while increasing total costs. Furthermore, if ILECs were not allowed to recover joint and common costs through pricing for UNEs, interconnection, and reciprocal compensation, such ILECs might attempt to recover joint and common costs

[13] Id. at para. 696.

[14] Id. at para. 697.

[15] Ibid.

[16] Ibid.

[17] *Cox Comments* at p. 3.

from their end users, resulting in pricing that would "distort competitive incentives," as it would not allow recovery of costs from competing carriers that are causing costs. In addition, because competing carriers that are causing costs would not be required to pay their share of joint and common costs, such competing carriers would be able to offer lower prices and would not have incentives to invest, which would create further competitive distortions. The Commission also included joint and common costs in its cost-based pricing standard to help minimize the impact of its pricing decisions on small ILECs.

The foregoing discussion indicates the reasons why the Commission decided to include joint and common costs in the calculation of forward-looking economic costs for the purpose of setting UNE and interconnection rates. The Commission also determined that the pricing standard used for setting UNE and interconnection rates should be used to set rates for reciprocal compensation, as the pricing standards contained in the Act in Section 252(d)(1) (for interconnection and UNEs) and Section 252(d)(2) (for reciprocal compensation) are sufficiently similar to permit the use of the same pricing methodology.[18] The Commission further noted that:

> there is some substitutability between the new entrant's use of unbundled network elements for transporting traffic and its use of transport under section 252(d)(2). Depending on the interconnection arrangements, carriers may transport traffic to the competing carriers' end offices or hand traffic off to competing carriers at meet points for termination on the competing carrier's networks. Transport of traffic for termination on a competing carrier's network is, therefore, largely indistinguishable from transport for termination of calls on a carrier's own network. *Thus, we conclude that transport of traffic should be priced based on the same cost-based standard, whether it is transport using unbundled elements or transport of traffic that originated on a competing carrier's network.*[19] (emphasis added)

[18] *See Local Competition Order* at para. 1054.

[19] Ibid.

The Commission also had sound reasons for using the same pricing standards for interconnection and UNEs that it used for reciprocal compensation. Because the transport of traffic for termination is accomplished in much the same manner whether it is done using UNEs or whether it is exchanged at a meet point, the Commission ordered that the same pricing standards be used. To do otherwise would have allowed for opportunities for arbitrage, in which the same service would have been priced differently depending upon the application for which the service was purchased.

The Commission has clearly considered whether reciprocal compensation should be priced in a different manner than UNEs and interconnection. For all of the reasons enumerated above and in our previous comments, the Nebraska Companies urge the Commission to continue to use the forward-looking economic cost method for pricing reciprocal compensation, which includes a reasonable allocation of joint and common costs.

III. The Commission Should Not Mandate Flat-Rated Recovery for Switching Costs, Rather, it Should Allow States to Determine the Appropriate Method to Recover Switching Costs.

AT&T Corp. ("AT&T") and MCI urge the Commission to mandate that switching costs can only be recovered on a flat-rated basis.[20] As the Nebraska Companies indicated in their comments in this proceeding, if the Commission were to require that switching costs be recovered solely through flat-rated charges, it would preclude cost recovery for

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[20] *See Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, Comments of AT&T Corp. (*"AT&T Comments"*) (filed Dec. 16, 2003) at p. 75, and Comments of MCI (*"MCI Comments"*) (filed Dec. 16, 2003) at p. 29.

termination, as its rules do not allow for flat-rated termination charges.[21] The Nebraska Companies believe that evidence indicates that a portion of local switching costs are usage-sensitive, and are appropriately recovered through a usage-based charge for termination.

AT&T and MCI both urge the Commission to mandate that switching costs can only be recovered on a flat-rated basis. However, their reasons for making these recommendations differ.

MCI argues that switching costs are not usage sensitive. Among the reasons MCI cites in making this claim are that switch vendor contracts contain per-line price structures that are volume and usage insensitive, and that the switch processor, the only potential usage-sensitive part of the switch, virtually never runs out of capacity.[22] The Nebraska Companies disagree with these arguments. The manner in which a switch contract is structured is not a useful indicator of cost causation. In other words, the execution of a contract amount on a per line basis does not provide an indication of whether estimations of switch usage were used to develop a per-line amount for contract purposes. With regard to the argument that the switch processor virtually never runs out of capacity, the Nebraska Companies note that the dictionary defines capacity as " the ability to contain, receive, or accommodate," and "the maximum amount or number that can be contained."[23] If switching costs were not sensitive to usage, then a discussion of switch capacity would be unnecessary and irrelevant.

[21] *See Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, Comments of the Nebraska Rural Independent Companies (*"Nebraska Companies' Comments"*) (filed Dec. 16, 2003) at p. 8.

[22] *See MCI Comments* at p. 30.

[23] Merriam-Webster, Dictionary, Home and Office Edition (1998).

Other commenting parties also dispute MCI's claim that switching costs are not usage sensitive. AT&T indicates that a portion of switching costs are based on "peak-period usage."[24] AT&T states that "[p]eak period costs are costs of equipment capacity that is engineered and purchased based on peak-period demand."[25] AT&T further explains that "[t]he costs of the capacity needed to meet this peak demand are considered usage-sensitive because they may vary with the amount of traffic during the peak period."[26]

The Nebraska Companies indicated in their comments that the Nebraska Public Service Commission ("NPSC") recently found that a portion of switch investment "is properly classified as usage sensitive."[27] The evidence the NPSC used in reaching its decision included examples of non-port factors that are considered in switch design including toll usage, local phone usage, and EAS.[28] The NPSC also noted that compliance with its service standards affects the amount of switch capacity that must be engineered by a LEC. Furthermore, the NPSC cited testimony noting that ". . . vendor ordering information relies on busy-hour estimates for all users of the switch and that the processor and matrix costs are based on these estimates and are traffic sensitive."[29]

While AT&T believes that a portion of switching costs are based on peak-period usage, AT&T does not advocate a usage-based charge for switching due to the difficulty

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[24] *AT&T Comments* at p. 76.

[25] Id. at p. 76-77.

[26] Id. at p. 77.

[27] *Nebraska Companies' Comments* at p. 9.

[28] Ibid.

[29] Ibid.

of implementing such a charge for peak-period usage.[30] AT&T advocates the use of a flat per-port fee that is assessed against all users of the network, as it believes that charging for switching on this basis would result in fewer economic inefficiencies than an average per-minute fee for switch usage.[31]

The Nebraska Companies agree that on a theoretical basis, peak-sensitive pricing may be the most economically efficient method of pricing for usage-sensitive switching costs. However, the Nebraska Companies believe that if the difficulties of implementing a peak-sensitive pricing mechanism are such that it is not practical to implement this structure, usage-sensitive pricing on another basis, such as an average per-minute fee, should not be prohibited by the Commission. As discussed above, if the Commission were to require that switching costs be recovered solely through flat-rated charges, it would preclude cost recovery for termination, as its rules do not allow for flat-rated termination charges. In the Local Competition Order, the Commission stated its belief that ". . . the costs of shared facilities should be recovered in a manner that efficiently apportions costs among users that share the facility."[32] Mandating flat-rated switching charges would mean that carriers that terminate their traffic on an ILEC's network would not share in the cost of providing switching in the ILEC's network. As such, mandating flat-rated switching charges would result in economic inefficiency, as it would allow carriers that terminate traffic on an ILEC's network to use the ILEC's switching resources at no cost. In ordering the use of traffic-sensitive charges for switching costs in

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[30] *See AT&T Comments* at p. 77.

[31] Ibid.

[32] *Local Competition Order* at para. 753.

the NPSC proceeding discussed above, the NPSC stated that "... switch costs should be shared by users of switching resources."[33] Thus, the NPSC recognized that under the Commission's rules, the use of flat-rated switching charges would not efficiently apportion costs among carriers that share the use of the ILEC's switch. Furthermore, as indicated by the Illinois Commerce Commission ("ICC"), although usage is not a precise measurement of each port's contribution to the total required capacity of a shared facility, a high usage port, statistically speaking, also makes a greater contribution to the total capacity.[34] Therefore, a usage-based rate structure can be used as a substitute for a contribution-based rate structure to reflect cost causation principles.[35]

The ICC indicates that the appropriate rate structure for switching varies with the circumstances. Based on this observation, the ICC recommends that the Commission should not prohibit a usage-based rate structure to recover the cost of the shared switching facility, but rather, it should "... allow state commission the flexibility to determine the appropriate rate structure for switching matrix and trunk ports in a specific circumstance."[36] The Nebraska Companies concur with this recommendation, and urge the Commission to continue the use of the rate structure for switching that it established in the Local Competition Order, that is, flat-rated charges for line ports and flat-rated or usage-based charges for the switching matrix and for trunk ports.[37]

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[33] *Nebraska Companies Comments* at p. 9.

[34] *See Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, Initial Comments of the Illinois Commerce Commission (filed Dec. 16, 2003) at p. 85.

[35] Id. at p. 86.

[36] Ibid.

[37] *See Local Competition Order* at para. 810 and 47 C.F.R. Section 51.509(b).

Maintaining the current rate structure for switching would allow state commissions to assess charges for termination of traffic. States should be allowed to order the recovery of termination charges from the party that is causing the cost. In the case of traffic terminating on an ILEC's network, the party causing the cost is the competing carrier. If states were not allowed to order the recovery of termination costs from competing carriers, termination costs will likely be passed on to the ILEC's end-user customers. This could become burdensome for rural ILEC end-user customers, and would violate the principle that costs should be recovered from the party that causes the cost. Furthermore, it could ultimately lead to reduced switch investment in order to lessen the burden on end-user customers.

IV. Conclusion

The Nebraska Companies believe that the rules adopted by the Commission in this proceeding are important to rural ILECs, as these rules will determine the amount of compensation rural ILECs receive for transport and termination, which is a growing proportion of the traffic handled by rural ILECs. As the Nebraska Companies indicated in their comments, appropriate pricing for transport and termination is necessary to maintain a balance in cost recovery among local rates, universal service, access and other forms of intercarrier compensation.[38]

The Commission should continue to use the TELRIC pricing rules for pricing of UNEs, interconnection, and transport and termination. The Commission should not adopt the recommendation of Cox that rates for transport and termination should be capped at long-run incremental cost, which would not include a reasonable share of joint and

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[38] See *Nebraska Companies' Comments* at p. 11.

common costs. As indicated by the Commission in the Local Competition Order, the exclusion of joint and common costs from rates charged to other carriers for use of the ILEC's network could result in economic inefficiencies.

The Nebraska Companies urge the Commission to continue to allow states to determine the appropriate rate structure for switching, based upon the Commission's current rules for the switching rate structure.[39] Mandating flat-rated charges for switching would not allow ILECs to recover costs for termination of other carriers' traffic. As such, flat-rated charges for switching would violate the Commission's stated belief that the costs of shared facilities should be recovered in a manner that efficiently apportions costs among users that share the facility. The ICC recommends that states should be allowed the flexibility to adopt a rate structure for switching that is appropriate for the specific circumstances of a given case, and the Nebraska Companies concur with this recommendation.

Dated: January 30, 2004.

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[39] 47 C.F.R. Section 51.509 (b).

Respectfully submitted,

The Rural Independent Companies

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Blair Telephone Company,
Cambridge Telephone Company,
Clarks Telecommunications Co.,
Consolidated Telephone Company,
Consolidated Telco Inc.,
Consolidated Telcom, Inc.
Eastern Nebraska Telephone Company,
Great Plains Communications, Inc.,
Hartington Telecommunications Co., Inc,
Hershey Cooperative Telephone Company, Inc.,
Hooper Telephone Company,
K&M Telephone Company, Inc.,
Nebcom, Inc.,
Nebraska Central Telephone Company,
Northeast Nebraska Telephone Company,
Pierce Telephone Co.,
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